D. Price Cap Regulation Should Be Simplified

With the implementation of the Act, the LEC access offerings face significant new competitive pressures. In order to compete in the access market, ILECs must be able to respond to changes in the market without significant delay or regulatory restriction.

First, the newly established LPR charge and EUCL should not be regulated by price caps. Instead, this charge should be a purely cost-based rate element. In order to avoid dramatic changes in the total burden placed on the payers of the LPR charge[6], Ameritech proposes that the LPR charge be based initially on current price cap revenues collected for BFPO, inside wire amoritization, switch line port and information surcharge and be transitioned in equal increments over five years to 25% of costs. On a going forward basis, embedded costs would be periodically reviewed by the Commission.

Second, in order to respond to the competitive offerings of CLECs, LECs should be able to "zone price" the EUCL consistent with zones used for unbundled loops in each state, subject to the existing overall EUCL caps.

With implementation of the Act, and the availability of unbundled network elements, a competitive provider of access services need not undertake any significant capital investment. No longer can it be argued that the exchange access/local exchange market is burdened with substantial entry or exit barriers. The price cap plan was originally established to simulate what would naturally happen to service prices in a competitive environment. The access market is highly competitive and a price cap is no longer necessary to regulate prices of many access services.

We recommend that the Commission establish the following triggers for the removal of certain rate elements from price caps:

[6]Under Ameritech's proposal, the current payers of the subsidies -- purchasers of interstate access services -- would remain the payers of the LPR charge. The only change is in the method of collecting the payment -- from MOUs purchased from ILECs -- to relative revenues.

1) Interexchange services should be entirely removed from price caps when 1+ presubscription has been implemented for interstate intraLATA (interexchange) services. These services are highly competitive today. With the implementation of 1+ presubscription for this traffic, no one can seriously argue that the LEC retains any unreasonable advantage.

2) For the following access elements, a direct competitive alternative clearly exists when their analog unbundled elements are available either under tariff or via a "Statement of Generally Available Terms", and either direct competition is demonstrated through CLEC or CAP provision of equivalent services, or purchases of that unbundled element are made:

transport
directory assistance
LIDB query
800 database query
originating local switching

3) Terminating local switching should be removed from price caps if an ILEC agrees to make it available to any carrier at the same rate that it charges under reciprocal compensation arrangements for termination of local traffic. This places terminating local switching in the same category as the network elements listed in 2), above.

To facilitate the removal of service from price caps and to provide the pricing flexibility commensurate with the new competitive environment created by the Act, all services should be placed in a single price cap basket. This would greatly simplify the administration of removing services and regulating the remaining price cap services. The TIC would be in a separate sub-basket and would not be permitted to be increased. No other sub-baskets should be created.

E. Access Pricing Must Be More Flexible

Even without the enactment of the Telecommunications Act of 1996, access competition has been developing rapidly in many markets. Ameritech faces competition for transport services from MFS, TCG, ICG, Brooks Fiber, MCI Metro, Time Warner and others. Focusing on DS1 and DS3 services, seven competitors have captured 30% of the midwest market and 51% of the Chicago market. Directory Assistance faces competitors everywhere including from newcomers like Excell, Clifton Forge, Frontier and Metro One.

In order for LECs to respond to the competitive pressures in the market place, the Commission should permit all access services (except for the LPR charge) to be zone priced and should allow LECs the streamlined contract tariffing capability similar to that granted to AT&T before it was classified as a non-dominant carrier.

III. Conclusion

As described above, Ameritech's proposal provides a comprehensive access reform plan that the Commission should adopt that removes and makes explicit subsidies currently embedded in access charges, realigns the switched access rate structure, simplifies price cap regulation and provides for access pricing flexibility.

If implemented for all LECs, our proposal would provide a viable and competitively neutral means of continuing the availability of affordable basic exchange service rates, while allowing competition to determine the ultimate level of access charges. Changes in price cap regulation are the other side of the access reform coin that are necessary to avoid unreasonable and uneconomic market distortion and to provide customers with the maximum benefit from the new competitive telecommunications market.

Appendix A to this proposal contains presentation materials previously used at the Commission to explain Ameritech's Access Reform proposal. These materials provide numerical and graphical of the concepts discussed in this paper.

APPENDIX A

ACCESS REFORM

Ameritech Recommendation

Ameritech

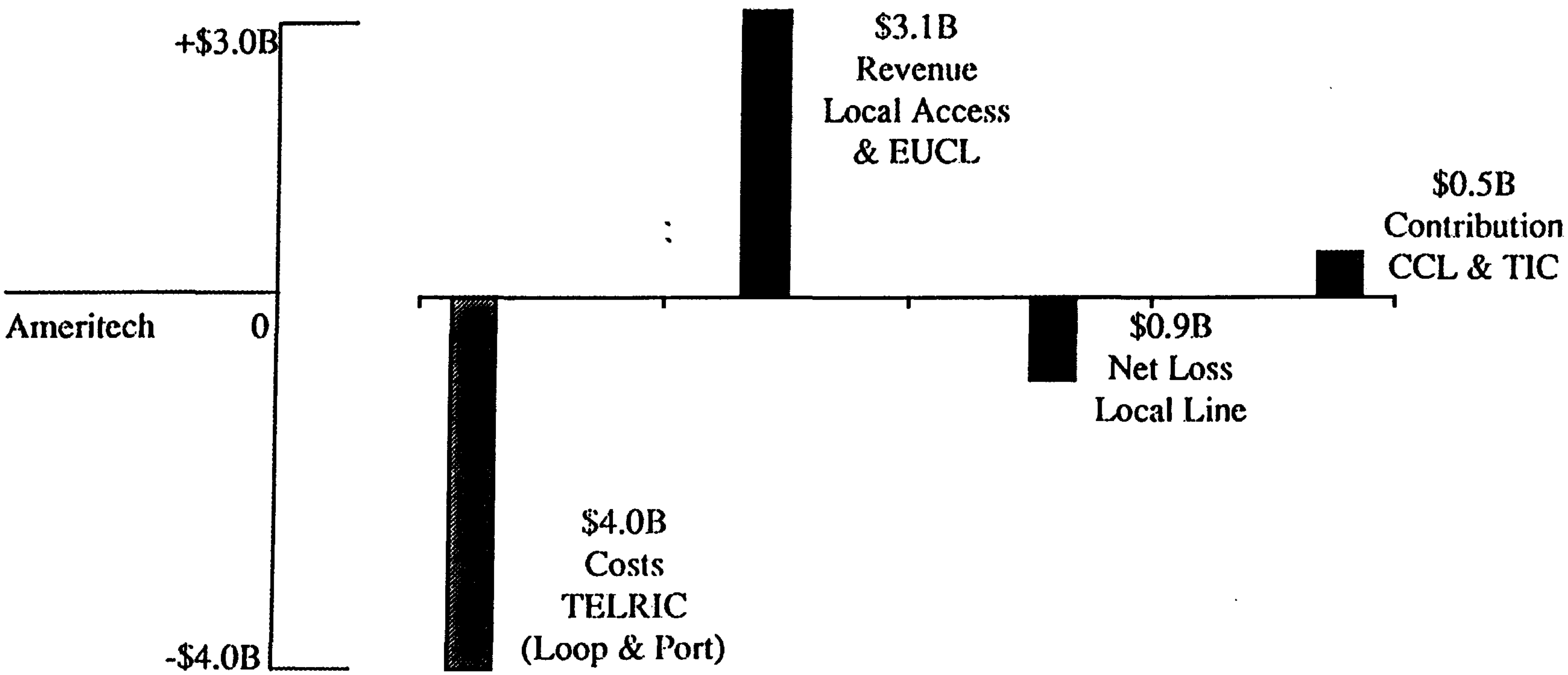
Access Reform - Key Issues for Ameritech

- The Access Reform docket must address the existing subsidies in interstate access rates

- The FCC should streamline its regulation of access charges so that all competitors can compete on equal terms in the marketplace

Local line prices are significantly below costs

For the Ameritech region Local Line Revenues are significantly short of costs including shared and common costs of the loop and port



For example, today a residential customer in Kalamazoo, Michigan pays $13.94 per month for their access line while the TELRIC for the loop and the port is $18.76. For each residential line in Kalamazoo, a contribution of $4.82 must come from other services.

Sources of revenue that contribute to the LECs ability to maintain below cost local exchange access line pricing will diminish

Contributions from Access:	Contributions from Other Sources:
Carrier Common Line	IntraLATA Toll Margins
Transport Interconnection Charge	Vertical Service Margin
Margins on Access Services	Urban Margins Contribute to Rural Rates
	Business Margins Contribute to Residence Rates

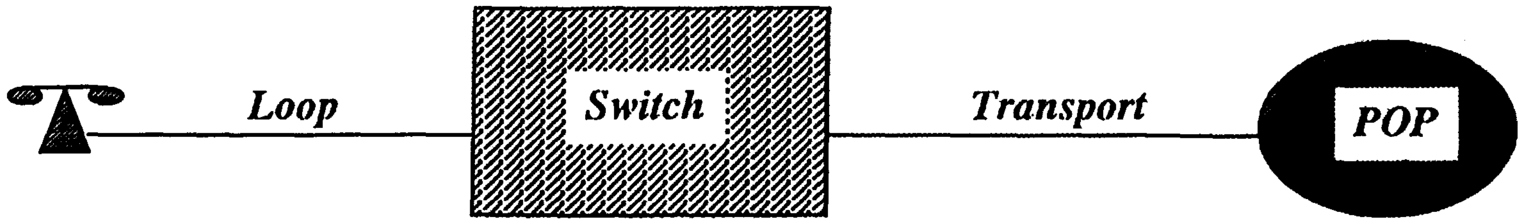
- ILECs can no longer count on retaining existing higher margins in toll and access services because of the developing 1+ intraLATA toll competition and the pressure to move access prices closer to TELRIC based unbundled network element pricing as the IXCs self-provide access

- ILECs can no longer count on the margins from vertical services because of developing local competition

- Competitors will target high margin communications intensive businesses and households

Today's access contributions support below cost local line prices

Switched Interstate Access Today



EUCL = $850
CCL excl LTS = $175

Local
Switching = $410
TIC = $335
Info
Surcharge = $ 10

Transport = $95

Total = $1,875

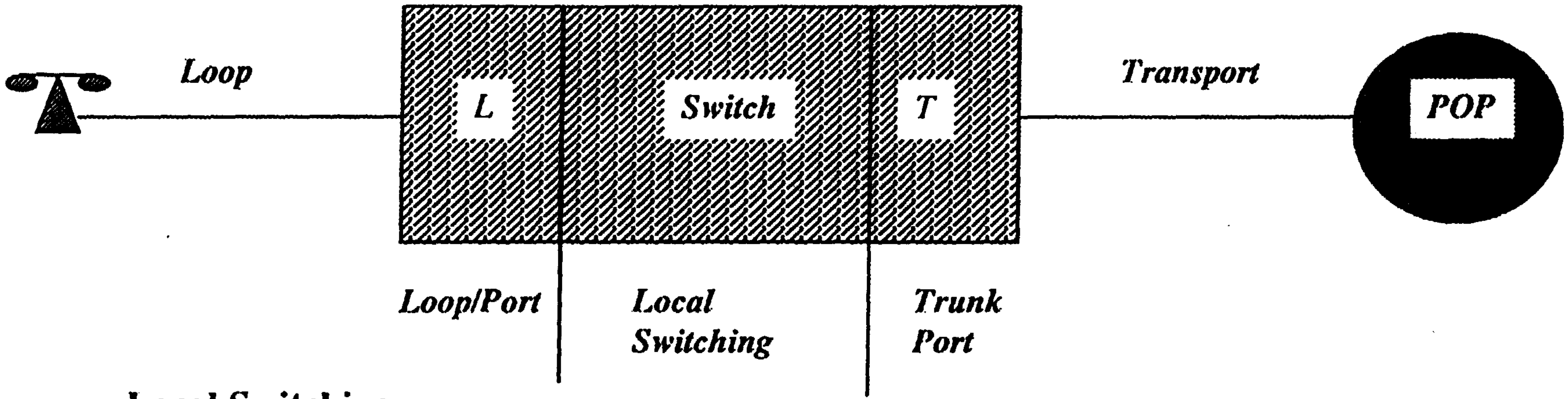
**Ameritech Revenues ($M)*

Access Reform
Recommended Solution

1) Realign Rate Elements
   - Remove the line port from local switching and associate with recovery of loop costs
   - Separate the remaining local switching element into a usage element and a flat rated monthly trunk port element
   - Transfer TIC to appropriate elements, phase out remainder over 3-5 years
   - Establish new loop and line port cost recovery mechanism outside of Price Caps - transition to recovery of 25% of total cost over 3-5 years

2) Form single Price Cap basket
   - Prices based on market forces and annual price cap mechanisms
   - Competition will drive prices to approach cost

Access Reform - Switched Access Rate Realignment



Local Switching

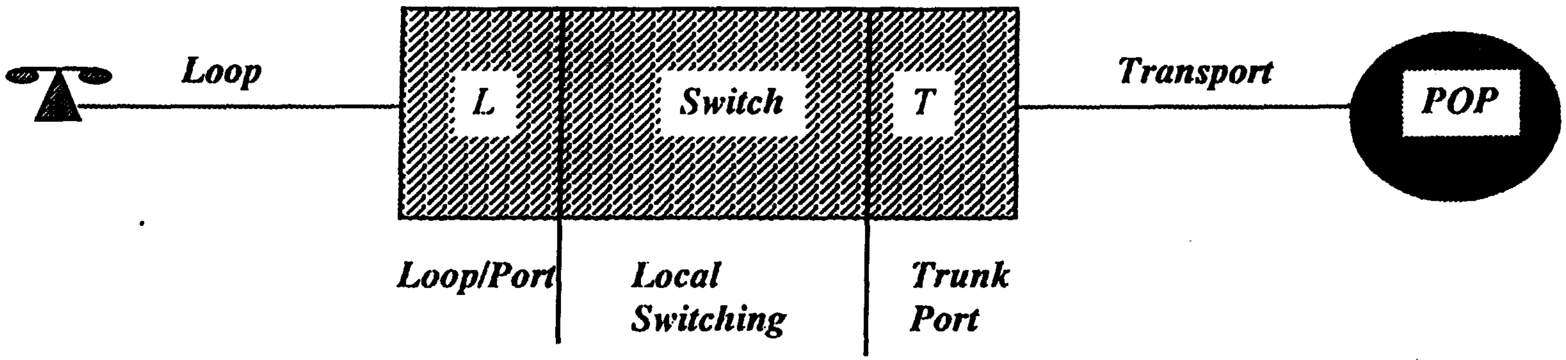
- Transfer NTS line termination and Info Surcharge amounts to Loop/Port recovery mechanism
- Establish flat rated trunk port charge which recovers cost of trunk port
- Recover remaining traffic sensitive local switching on per minute of use basis

TIC

- Transfer tandem and SS7* related costs to appropriate access rate elements
- Bill remainder to IXCs as a transitional surcharge - this amount to be phased out over 3-5 years

** SS7 related costs already removed from Ameritech TIC (Trans #982)*

Access Reform - Switched Access Rate Realignment



Carrier Common Line

Base Factor Portion Overflow (BFPO)

- Transfer BFPO and other loop related costs to Loop/Port recovery mechanisms
- Remove pay telephone costs from common line in accordance with FCC 96-128 Order

NECA Long Term Support (LTS)

- If LTS is not subsumed by universal service, the FCC should direct NECA to bill IXCs directly

Loop/Port recovery mechanism

- Full interstate loop and line port costs recovered by a combination of EUCL and Loop/Port Recovery Charge to interstate long distance carriers
- Transfer Non Traffic Sensitive (NTS) Line Termination and Info Surcharge amounts from Local Switching to Loop/Port
- After initial per loop charge calculation, recovery is transitioned over 3-5 years to 25% of cost for each loop used to provide local service
- Allow geographically deaveraged rates for EUCL consistent with unbundled elements

Mapping Today's Rate Elements to Switched Access Rate Realignment

Today			*Recommended Initial Charges*	
EUCL	$ 850M	(850)	Loop/Port Recovery Mechanism (EUCL and Loop/Port Recovery Charge) *Transition to 25% of cost*	$1,145M
CCL excl LTS	$ 175M	(175)		
Information Surcharge	$ 10M	(10)		
Local Switching	$ 410M	(110) (275) (25)	Local Switching	$ 275M
			Trunk Port	$ 25M
TIC	$ 335M	(310) (25)	TIC transition *Phase out in 5 years*	$ 310M
Transport	$ 95M	(95)	Transport	$ 120M
TOTAL	**$1,875M**		**TOTAL**	**$1,875M**

Access Reform -
Price Cap Revisions

- Loop and line port cost recovery (Common Line) removed from Price Caps
- Simplify treatment of remaining Access Services
  - Aggregate into a single Price Cap Basket
  - Transitional TIC would reside in a sub-band
- Allow rate structure flexibility, including establishing zones, consistent with unbundled network elements
- Ability to establish new services without cost support or Part 69 waiver
- Competitive services removed from Price Caps
  - Existing IX basket
  - Transport
  - Directory Assistance Services

Eliminate Price Regulation for Competitive Access Services

- Services should be declared competitive and removed from Price Caps when equivalent unbundled elements are being purchased or direct competition exists (i.e., Transport, Directory Assistance, Query)
  - Unbundled transport is a direct substitute for access transport services
  - Market forces and the availability of unbundled elements will drive prices
- Remaining services should be removed from Price Caps when unbundled elements or local transport and termination are available to access customers
  - An effective market alternative to originating Switched Access exists when unbundled elements of Loop, Port and Local Switching are generally available
  - LECs should be given option after the transitional period to allow reciprocal compensation for all traffic, removing terminating Switched Access from Price Caps

All Access Services should be removed from Price Caps when alternatives exist

Triggers for Change of Regulations

Triggers	Change of Regulations
• 1+ Interstate IntraLATA	Remove IX basket from Price Caps
• Approved Unbundled Element Tariff and either direct competition or demonstrated purchases of unbundled network elements (e.g., loops)	Remove Access Service from Price Caps - Transport - Directory Assistance - Query - LIDB - Query - 800 Database - Originating Switched Access
• Reciprocal compensation available for Terminating Access	Remove Terminating Switched Access from Price Caps

Regulations must be uniformly applicable to all competitors

Transport and Directory Assistance already have robust competitive environments

- Transport
  - Transport competitors include: MFS, TCG, ICG, Brooks, MCI Metro, Time Warner and others
  - DS1 and DS3: Seven competitors have captured 30% of Midwest market and 51% of the Chicago market

- Directory Assistance
  - Directory Assistance competitors are everywhere, including newcomers Excell, Clifton Forge, Frontier, Metro One
  - GTE has captured 30% of Midwest Directory Assistance market
  - Two large IXCs are evaluating proposals to move all Directory Assistance away from Ameritech

Regulations can be removed Service by Service

Access Reform - Access Pricing Flexibility

- Expand geographic pricing to all rate elements
- Location specific pricing (individual buildings)
- Flexible term plans and options to serve individual customer needs
- Promotional pricing (90 day service offerings and pricing plans)
- ICB/Contract pricing

Need flexibility to respond to competition

Loop and Line Port Recovery (LPR) Mechanism

A)	25% of Loop and Port Cost	$400M
B)	Amount recovered through EUCL	$304M
C)	Under-recovery of Interstate Loop/Port Cost (A - B)	$ 96M
D)	Number of Lines	4M
E)	Average Dollars Per Line Per Month (EUCL Less than 25%) (C / D / 12 = E)	$ 2.00
F)	Average Number of Lines (EUCL Less Than 25%)	3.8M
G)	This Month's Gross LPR (E x F = G)	$7.6M
H)	Amount Recovered by Universal Service Fund for Interstate Portion	?
I)	This Month's LPR (G - H = I)	$7.6M
J)	IXC - ABC Interstate Toll Revenues in the State	$400M
K)	Total IXC Interstate Toll Revenues in the State	$2000M
L)	% of IXC - ABC Interstate Toll Revenues in the State	20%
M)	This Month's IXC - ABC LPR (L x I = M)	$1.52M

Notes:	***A-E***	***Calculated once every year***
	F-I, M	***Calculated each month***
	J-L	***Calculated each quarter***

Ameritech Interstate Access Reform Proposal
Switched Revenue Example ($M)

Proposed Access Reform Structure	1997	1998	1999	2000	2001	2002
EUCL	850	850	850	850	850	850
Loop/Port Recovery Charge	295	281	267	253	239	225
Local Switching	275	257	239	221	203	185
Trunk Port	25	25	25	25	25	25
TIC	310	248	186	124	62	0
Transport	120	112	104	96	88	80
Total Switched Access	1,875	1,773	1,671	1,569	1,467	1,365
Maximum Revenue allowed under Price Caps	1,875	1,846	1,818	1,789	1,761	1,732

Notes:
* Assumes constant 1996 demand at projected yearly prices
* EUCL prices assumed constant
* Loop/Port Recovery Charge is transition over five years from today's revenues to embedded cost model
* Local Switching and Transport prices are based on market rates
* TIC priced is eliminated over five years beginning 1/1/98
* Price Cap reduced annually by 2% of Local Switching, Trunk Port, TIC and Transport plus reduction in LPR transition

ATTACHMENT B

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ACCESS, REGULATORY POLICY, AND COMPETITION

by

Kenneth Gordon

Senior Vice President

on behalf of Ameritech

January 29, 1997

ACCESS, REGULATORY POLICY, AND COMPETITION

I. INTRODUCTION

Interstate access rates are not now, and have not been for a long time, at economically efficient levels. Interstate access charges deviate from economic efficiency primarily because the current rate structure provides for the recovery of non-traffic sensitive (NTS) costs in usage-based prices, and access rates do not vary by geographic regions even though cost most likely does vary by geography. As a consequence, prices of telephone services to end users depart from efficient levels as well. Such divergence is unlikely to coexist easily with open entry conditions and a competitive market-place.

As I will explain in detail in Section II of this affidavit, these distorted prices are a result of a combination of administrative actions by regulators and courts intended to achieve certain social and political goals. Manipulating access rates in this way is feasible (whether or not it is desirable is a separate question) in a monopoly setting; competitive markets, however, give no special deference to political decisions that result in prices deviating from principles of economic efficiency. Therefore, the development of, and, more importantly, the prospect for additional, local exchange and access competition has tolled the death-knell of the current interstate access rate structure. Hearing that bell toll, the Federal Communications Commission (FCC or Commission) has opened a proceeding on access reform in order to "reform [its] system of interstate access charges to make it compatible with the competitive paradigm established by the 1996 Act and with state actions to open local networks to competition." FCC 96-488, Notice of Proposed Rulemaking, Third Report and Order, and Notice of Inquiry, CC Dockets No. 96-262, 94-1, 91-213, and 96-263, released December 24, 1996 (hereafter, "FCC Notice" or "Notice"), ¶ 1. The Commission has stated that it also seeks "to eliminate, either now or as soon as changes in the marketplace permit, any unnecessary regulatory requirements on incumbent LEC exchange access services." FCC Notice, ¶ 5.

The Commission has proposed specific changes to the existing access charge rate structure and has offered for comment two distinct approaches for interstate access charges to transition to economically-efficient levels: (1) a market-based approach that relies on emerging competitive forces; and (2) prescriptive regulatory rate changes. Section III of this affidavit will include my analysis of -- and general agreement with -- the Commission's proposed rate structure changes. In Section IV, I conclude that the Commission should allow the marketplace forces that Congress, the Commission itself, and state regulators have set in motion to do the job that these forces are intended to do, and are capable of doing -- drive rates to economically-efficient levels as competition spreads. A prescriptive approach is not necessary for the development of competition for access and interexchange services -- could in fact damage it -- and would represent an unnecessary regulatory intrusion into the workings of the competitive process and an abandonment of the principles behind the Commission's price cap rules. I will also explain why the Commission should not be worried about ILECs engaging in an anticompetitive "price squeeze" strategy during the market-based transition to efficient access charges.

In the market-based approach, the Commission proposed certain "phases" for the gradual reduction of regulatory requirements applied to ILECs as the access market becomes more competitive. The Commission should view the market-based approach in terms of potential competition at Phase 1 and an actual competitive presence at Phase 2. Ameritech recommends that the Commission grant the following statewide relief to the ILEC at Phase 1: (i) allow geographic rate deaveraging for all access services; (ii) permit promotional pricing, such as volume and term discounts; (iii) allow contract pricing; (iv) deregulate new services; (v) lower the "no earnings sharing" X-factor in the price cap from 5.3 to 4.0; and (vi) permit growth discounts. I conclude that all of these are appropriate. At Phase 2, relief should consist of non-dominant treatment by service and geographic area. Section V of this affidavit includes my analysis of the Commission's proposed "phases and triggers" and Ameritech's recommendations.

II. THE PAST AS PARTIAL PROLOGUE: ACCESS CHARGE HISTORY

One purpose of studying history is to learn from the past so as not to repeat its mistakes. We study it, as well, so as not to chart our future on a foundation of false premises. Sound policy demands that we know the true starting point for our policy initiatives. This industry, which for most of its existence was dominated by AT&T's Bell system monopoly, has been subject to 60 years of state and federal regulatory policies that were substantially devoted to creating and distributing subsidies to rural customers, residential customers, and to selected other customers and interests. Because of this, there are two, not one, essential policy problems to be resolved today in telecommunications. The first policy problem -- how to ensure productive and allocative efficiency -- will only be achieved in an open, competitive marketplace. The second policy problem -- how to manage continuing subsidy flows as competition is introduced -- requires careful regulatory attention and an awareness of past subsidy practices.

It is important to understand, however, that conceding the probability of efficiency gains through reliance on market forces does not mean that real benefits can simply be "ordered up" by regulatory fiat and an administrative determination of "true economic" cost. Nor does it mean that any particular service that is priced above economic cost, access for example, is priced above cost as a result of inefficiency. Only market processes will reveal the necessary information and opportunities to achieve real, sustainable benefits from competition. That is precisely why Congress chose competition in an open market place to replace the traditional regulated monopoly structure for the industry. It is certain, though, that operating and organizational inefficiency is <u>not</u> the only, and probably not the central, cause of "too high" access prices in the telephone industry.

Prices charged by telephone companies have been highly controversial over the years for two services in particular: local exchange (local loop) service and carrier access. Political sensitivities and well-intentioned policy goals have led to policies designed to keep local exchange rates as low as possible, in part by keeping toll and access rates high.